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IN THE
Supreme Court of the United States
October Term, 1980

No. 80-19

HARRY LEWIS and SYLVIA BAKER,
Petitioners,

v.

WILLIAM H. ANDERSON, S. CLARK BEISE, SHIRLEY T. BLACK, ROY E. DISNEY, RONALD W. MILLER, RICHARD T. MORROW, DONN B. TATUM, E. CARDON WALKER, RAYMOND L. WATSON, WALT DISNEY PRODUCTIONS, GEORGE L. BAGNALL and GORDON E. YOUNGMAN,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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WILLIAM H. ANDERSON, S. CLARK BEISE, SHIRLEY T. BLACK, ROY E. DISNEY, RONALD W. MILLER, RICHARD T. MORROW, DONN B. TATUM, E. CARDON WALKER, RAYMOND L. WATSON, WALT DISNEY PRODUCTIONS, GEORGE L. BAGNALL and GORDON E. YOUNGMAN,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners, Harry Lewis and Sylvia Baker, respectfully pray that this Court grant a Writ of Certiorari to review the opinion and order of the United States Court of Appeals for the Ninth Circuit entered on October 29, 1979.

That decision affirmed the order of partial summary judgment rendered by the United States District Court for the Central District of California in favor of the defendants. The Court of Appeals granted plaintiff permission to appeal the order of partial summary judgment on certified issues of law pursuant to 28 U.S.C. §1292(b).

OPINIONS BELOW

The opinion of the Court of Appeals (Appended, hereinafter "App" A) was entered October 29, 1979 and reported at 615 F.2d 778 (hereinafter "*Lewis*").

A written opinion was not issued by the United States District Court for the Central District of California. The District Court issued Findings of Fact and Conclusions of Law for Partial Summary Judgment which was entered on August 9, 1978 (App B). The Partial Summary Judgment rendered by the District Court was entered on August 9, 1978 (App C).

The Order of the Court of Appeals granting plaintiffs' petition for permission to appeal pursuant to 28 U.S.C. §1292(b) was entered on January 11, 1979 (App D).

JURISDICTION

The order of the Court of Appeals for the Ninth Circuit was entered on October 29, 1979. (Wright and Goodwin, Circuit Judges; Solomon, Senior District Judge of the District of Oregon.) An order of the Court of Appeals denying petitioners' petition for rehearing and rejecting the suggestion for a rehearing en banc was entered April 9, 1980 (Wright, Goodwin, Circuit Judges, Solomon, Senior District Judge) (App E).

The jurisdiction of this Court is invoked under 28 U.S.C. §1254(i)

QUESTIONS PRESENTED

1. Whether a committee of disinterested directors may terminate a non-frivolous stockholders' derivative action brought against a majority of the directors under §14(a) of the Securities Exchange Act of 1934 (15 U.S.C. §78n(a)).

2. Whether a committee of disinterested directors may

terminate a non-frivolous stockholders' derivative action brought against a majority of the directors under §10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j(b)).

STATUTES AND RULES INVOLVED

Section 10(b)(15 U.S.C. §78j(b)) and rule 10b-5 promulgated thereunder (17 C.F.R. §240.10b-5) and 14(a) (15 U.S.C. §78n(a)) and Rule 14(a)9 promulgated thereunder (17 C.F.R. 240.14a-9) of the Securities Exchange Act of 1934 (''1934 Act'') are set forth in App F to this petition.

STATEMENT OF THE CASE

This is a stockholders' derivative action brought on behalf of WALT DISNEY PRODUCTIONS (''Disney'') against its directors and senior officers. The action is based upon grants of stock options purportedly made under the authority of Disney's 1973 stock option plan which required and received the approval of a majority of the stockholders. By its terms, the plan prohibited a reduction of the exercise price of options granted thereunder or any increase above the maximum number of shares provided for under the plan, unless said acts were approved by a majority of the stockholders.

It is claimed that Disney's six senior officers, who, at all relevant times, constituted two-thirds of the nine man Board of Directors (''inside directors'') caused the Stock Option Committee to grant options upon condition that within a specified period thereafter, the optionees cancel outstanding options which had been granted to them, to purchase an equal number of shares exercisable at higher prices (''Conditional Grants''). It is claimed that the prime beneficiaries of the alleged wrongful acts were the inside directors. It is claimed that the Conditional Grants con-

stituted a violation of the price provision of the 1973 stock option plan and in addition, the maximum share provision was violated. It is asserted that these acts required stockholder approval, which was never obtained. It is asserted that the grants of the options were illegal, fraudulent and constitute waste.

In addition, it is charged that the Conditional Grants were caused to be made by the six inside directors at a time when they had material inside information that Disney's earnings would have a meteoric increase which they knew would cause a substantial rise in the market price of Disney's stock. It is asserted that this constituted a violation of §10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder.

Petitioners further claim material violations of §14(a) of the 1934 Act as follows: (1) the approval of the stockholders to the 1973 plan was procured by a false or misleading proxy statement in that (a) the 1973 proxy statement asserted that the Board of Directors had approved the 1973 plan, when in fact the Board of Directors had never seen or approved any of the terms of the plan; (b) the 1973 proxy statement contained materially false or misleading statements and omitted material facts in connection with the terms of the 1973 Plan; and (c) the 1973 proxy statement omitted material facts as to the executive compensation received by the officer-directors; (2) that the January 7, 1977 proxy statement contained materially false or misleading statements and omitted material facts in connection with the factual basis upon which the ratification was sought and in addition, omitted material facts in connection with the executive compensation received by officer-directors.*

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*The January 1977 proxy statement was issued to procure stockholders' ratification of the Stock Option Committee's authority to grant the conditional options and to procure the election of Disney's Board of Directors including the three members who comprised the Special Litigation Committee. The invalidity of this election would render the Special Litigation Committee's subsequent business determination void.

In April 1976, Disney's Executive Committee, which was comprised of three inside directors, appointed a Special Litigation Committee, specifically under §822 of the California General Corporation Law, and delegated to it the authority to exercise all of the powers of the Board of Directors in relation to the instant action. The appointment was also subject to Section IV of the By-Laws which permitted the Board of Directors to remove any or all members of the Committee with or without cause. The Special Litigation Committee was comprised of two directors who were elected subsequent to the action and one director who was a defendant but who is not alleged to have profited from the challenged transactions. In June 1976, the Board of Directors, which was comprised of the six inside directors and the three members of the Special Litigation Committee, ratified the aforesaid acts of the Executive Committee.

The Special Litigation Committee, in August 1977, determined, irrespective of the merits, that the instant action should be dismissed.

As a consequence of the determination of the Special Litigation Committee, Disney moved for summary judgment. Plaintiffs cross-moved for summary judgment.*

Both motions were originally denied but the District Court reserved a further hearing on specific issues, including the issues of the authority of the Special Litigation Committee to exercise business judgment to dismiss an action under California law and whether a dismissal of the action predicated on the exercise of business judgment by the Special Litigation Committee was consistent with the underlying federal policy of §§10(b) and 14(a) of the 1934 Act.

At a subsequent hearing, the District Court rendered an order of partial summary judgment which is the subject of this petition (App C).

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*The individual defendants sought, among other things, summary judgment on the merits of the §§14(a) and 10(b) claims. The District Court denied defendants' motion on the ground that there existed material issues of facts as to all claims.

In its order of partial summary judgment, the District Court declared that the partial summary judgment involves controlling issues of law as to which there were substantial grounds for difference, including whether a dismissal of the action violated §§10(b) and 14(a), and that an immediate appeal may materially advance the ultimate termination of the litigation in the case (App C). Plaintiff petitioned the Court of Appeals for the Ninth Circuit for permission to appeal pursuant to 28 U.S.C. §1292(b) on each of the issues certified by the District Court (App D). On January 11, 1979, the Court of Appeals granted plaintiffs' petition for permission to appeal (App E).

The Court of Appeals Opinion

In an opinion captioned *Lewis v. Anderson,* 615 F.2d 778, entered on October 29, 1979 (App A) the Court of Appeals affirmed the District Court's order of partial summary judgment in favor of defendants. *Lewis* followed the two part test formulated by this Court in *Burks v. Lasker,* 441 U.S. 471 (1979) which it summarized as follows:

> "(1) whether California law requires the dismissal of an action once a duly delegated committee determines that the action is not in the corporation's best interests and (2) whether such a rule is consistent with [§§14(a) and 10(b) of] the Securities Exchange Act of 1934. (A4)"

In applying the first tier of the *Burks* test, the *Lewis* opinion noted that the California Supreme Court has never decided the specific issue presented.* The Court of Appeals, in deciding that

*The *Lewis* opinion ignored a California intermediate Appellate Court decision, *Burt v. Irvine,* 237 C.A.2d 828, 862-3, 47 Cal. Rptr. 392 (Cal. Dist. Ct. of Appeal, 1st Dept. 1965), cited by appellants in their petition for reargument, which specifically equated a determination by a board of directors to seek dismissal of a stockholders' derivative action with ratification. *Burt* held, in the first instance, that a board's decision that an action should not be maintained must be made by a majority of the *total* board who are independent of the wrongs. *Burt* also reiterated the long standing California rule that gifts, waste or illegal acts cannot be ratified by less than the unanimous approval of stockholders.

California law would require the dismissal of a stockholder's action once a committee of disinterested directors determined that the action should not be maintained, followed the holdings of two recent cases applying the law of other jurisdictions — *Abbey v. Control Data Corp.*, 603 F.2d 724 (8 Cir. 1979), cert. denied, 100 S.Ct. 670 (applying Delaware law)* and *Auerbach v. Bennett,* 47 N.Y.2d 619, 419 N.Y.S.2d 920 (1979) (applying New York law).

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* *Lewis* stated:

> "*Abbey* is particularly helpful here, not only because it is the first post-*Burks* decision by a federal court of appeals, but also because the Delaware statute construed is almost identical to the California statute. (A6)"

Subsequent to *Abbey,* the Court of Chancery of the State of Delaware in *Maldonado v. Flynn,* Del. Ch. 413 A.2d 1251 (1980) (appeal pending) (hereinafter "Maldonado Delaware"), the first Delaware court to decide the issue of whether a committee of directors could compel dismissal of a stockholder's derivative action, determined that, under well-established Delaware law a committee of directors could not compel the dismissal of a stockholder's derivative action alleging breaches of fiduciary duty by directors. In *Maldonado,* the Court stated:

> "The business judgment rule is a *defensive rule,* the effect of which is to permit corporate directors to exercise their discretion in managing the corporation's business affairs n the manner they deem in the corporation's best interests in accordance with their power to govern the corporation pursuant to 8 Del. C. §141(a)." (Emphasis added)
>
> * * *
>
> "Several recent federal courts have cited the business judgment rule as the basis for granting a motion to dismiss a stockholder derivative suit against a corporation and its directors when the corporate directors, or a committee thereof, in their collective business judgment, determined that the suit was not in the best interests of the corporation. [Citing, among other cases, *Lewis* and *Abbey.*]."
>
> "All of these cited federal cases correctly state the business judgment rule, but incorrectly assume that State law necessarily enables the corporate directors (or a committee thereof) to compel the dismissal of a pending stockholders' derivative suit by invoking the business judgment rule. (413 A.2d at 1256)

Maldonado was subsequently followed in *Maher v. Zapata,* —F.Supp.— (D. Tex., Houston Div., May 27, 1980).

Lewis, in applying the second tier of the *Burks* test, then held that the "business judgment rule," as utilized in this case to compel the dismissal of a stockholders' derivative action, would be consistent with §§14(a) and 10(b) of the 1934 Act.

Lewis, in discussing the application of the business judgment rule to dismiss a §10(b) claim, stated:

> "The business judgment rule, as we interpret it, would not bar a derivative action when a special litigation committee of disinterested directors dismisses an action in bad faith. It operates only to insulate the committee's good faith decision to dismiss an action, even if the decision is negligent." (A8)

Lewis then stated that the reasoning applied to §10(b) claims is equally applicable to §14(a) claims. *Lewis* stated:

> "Allowing disinterested directors to exercise their business judgment to dismiss what they see as groundless causes of action would in no way weaken the regulatory provisions of the federal securities law. So long as those accused of manipulating the proxy vote are excluded from deciding whether or not to pursue the claim, there is no conflict between the business judgment rule and §14(a). (A9-10)."

REASONS FOR GRANTING THE PETITION

A.

This Court, in *Burks v. Lasker, supra*, 441 U.S. 471, held that if a state law permits directors to cause the dismissal of a stockholder's derivative action on the ground that the directors determined that the action should not be maintained, the federal court must then determine whether this application of state law is consistent with the policy of the federal statute under which the action is brought.

In *Burks*, this Court admonished federal courts to "be ever vigilant to insure that application of state law poses 'no significant threat to any identifiable federal policy or interest

. . .' *Wallis v. Pan American Petroleum Corp.*, 384 U.S. 63, 68 (1966)" and "The 'consistency' test guarantees that '[n]othing that the state can do will be allowed to destroy the federal right', *Board of Commissioners v. United States* [308 U.S. 343, 350 (1939)]." (441 U.S. at 479-80).

Petitioners submit that contrary to this Court's direction in *Burks, Lewis* did not analyze the policy enunciated in §§10(b) and 14(a) in order to determine whether utilization of business judgment to dismiss a non-frivolous action would interfere with the congressional objectives of those sections. Instead, *Lewis* determined that enforcement of those sections may be barred and the congressional intent frustrated, unless plaintiffs are able to establish that the Special Litigation Committee's decision was made in bad faith.

Petitioners submit that *Lewis,* in holding that business judgment is consistent with §§14(a) and 10(b), is in conflict with *J.I. Case Co. v. Borak,* 377 U.S. 426 (1964) and *Superintendent of Insurance of the State of New York v. Bankers Life and Casualty Company,* 404 U.S. 6 (1971).

In *Borak* the strong regulatory purpose of §14(a) was set forth as follows:

> "The purpose of §14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitations . . .
>
> "While this language makes no specific reference to a private right of action, among its chief purposes if '*the protection of investors*', which certainly implies the availability of judicial relief where necessary to achieve that result." (Emphasis added) (377 U.S. at 431-2).

Borak held that the stockholder's derivative action was an essential means to redressing §14(a) claims (377 U.S. at 433).

In discussing the issue of interference of state law

(security for expense statute) with the federal regulation of proxy solicitations under §14(a) of the 1934 Act, *Borak* stated:

> "[I]f the law of the State happened to attach no responsibility to the use of misleading proxy statements the whole purpose of the section might be frustrated." (377 U.S. at 434-5)

Borak held that a state security for expense statute could not interfere with a stockholder's derivative action seeking to redress §14(a) claims despite the fact that this Court, in *Cohen v. Beneficial Corporation,* 337 U.S. 541 (1949) in upholding the constitutionality of a similar security for expense statute, opined:

> "It is urged that such a requirement [security for expenses] will foreclose resort by most stockholders to the only available judicial remedy for the protection of their rights. Of course, to require security for the payment of any kind of expense of litigation, has a deterring effect. *But we deal with power, not wisdom; and we think, notwithstanding this tendency, it is within the power of a state to close its courts to this type of litigation if the condition of reasonable security is not met."* (Emphasis added)

Although *Burks* did not specify which federal statutes business judgment would be inconsist with, it is clear that §14(a) was one of the statutes. It is significant that *Burks* relied extensively on *Borak* in reaching the determination.

In *Burks,* the Supreme Court stated:

> "[A]s we held in *J.I. Case Co. v. Borak,* 377 U.S. 426, 432 (1964) '[t]o hold that derivative actions are not within the sweep of the [right]' would . . . be tantamount to a denial of private relief." (441 U.S. at 475)

Burks further stated:

> "Since we proceed on the premise of the existence of a

federal cause of action, it is clear that 'our decision is not controlled by *Erie R. Co. v. Tompkins,* 304 U.S. 64' and state law does not operate of its own force [citations]. Rather, '[w]hen a federal statute condemns an act as unlawful, the extent and nature of the legal consequences of the condemnation, though left by the statute to judicial determination, are nevertheless federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted [citing cases]. Legal rules which impact significantly upon the effectuation of federal rights must, therefore, be treated as raising federal questions. . . . See . . . *'J.I. Case Co. v. Borak,* 377 U.S. at 435 (security for expense statute). . . . Thus 'the overriding federal law applicable here would, *where the facts required,* control the appropriateness of redress despite provisions of state corporate law. . . . *J.I. Case Co. vs. Borak,* 377 U.S. at 434." (Emphasis in original) (414 U.S. at 476-477)

Burks stated:

> "This is not a situation where federal policy requires uniformity, and therefore where the very application of varying state laws would itself be inconsistent with federal interest." (441 U.S. at 479)

Section 14(a) is precisely the situation where federal policy requires uniformity. Pursuant to §14(a), the Securities and Exchange Commission promulgated rules setting minimum standards which must be met when soliciting proxy statements in order to comply with the section. See Schedule 14A-17C.F.R. §240.14a-101.*

It is clear that any state law which bars enforcement of violations of the standards established by the Securities and Exchange Commission would be inconsistent with the congressional policy enunciated in that section.

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*In *Maldonado v. Flynn,* 397 F.2d 789 n.9 (2d Cir. 1979), the Court stated:

> "Schedule 14A sets minimum standards. Compliance with the Schedule does not necessarily mean that a proxy statement satisfied Rule 14a-9 [citing case]."

The Delaware Court of Chancery, in *Maldonado v. Flynn, supra,* 413 A.2d 1251 (1980) and The Court of Civil Appeals, Fifth Supreme Judicial District of Texas at Dallas, in *Zauber v. Murray Savings Association,* 591 S.W.2d 932 (1979), determined that directors cannot utilize their business judgment to compel the dismissal of a properly instituted stockholder's derivative action. This is to be contrasted with *Auerbach v. Bennett,* 47 N.Y.2d 619, 419 N.Y.S.2d 920, (1979) (applying New York law) and *Lewis* (applying California law) which held to the contrary.

If the business judgment rule is held to be applicable to dismissing suits asserting §14(a) claims, it follows that the stockholder in a Delaware or Texas corporation could procure redress from the directors issuing false proxy statements while a stockholder of a California or New York corporation could be prevented from procuring redress for exactly the same wrongful acts. This renders the concept of a uniform application of the proxy rules throughout the country a nullity.

B.

Subsequent to the *Burks* decision, there have been two decisions by Circuit Courts of Appeals, other than *Lewis,* that have considered the issue of whether the "so-called" "business judgment rule" is consistent with the federal policy underlying §14(a): *Abbey v. Control Data Corp., supra,* 603 F.2d 724 (8 Cir. 1979) *cert denied,* 100 S.Ct. 670 (1980), and *Galef v. Alexander,* 615 F.2d 51 (2d Cir. 1980).

The application of the *Burks* test to the §14(a) claims in both those decisions is at variance with the application of the *Burks* test in *Lewis.* In contrast to *Lewis,* both *Abbey* and *Galef* analyzed the §14(a) claims to determine whether the dismissal of the derivative action was *consistent* with the underlying federal policy enunciated in §14(a).

In *Abbey,* the Court of Appeals, in analyzing the §14(a) claims alleged in that case, determined that the District Court did not err in dismissing the complaint under the business judgment rule because the §14(a) claims were at

best weak.*

The Eighth Circuit, in applying the *Burks* test, held:

> "Consequently, we determine that Abbey's §14(a) claim is also at best marginally related to the federal policies underlying that section (603 F.2d at 732)."

Abbey does not determine whether a state rule permitting directors to compel dismissal of a *non*-frivolous stockholder's derivative action alleging §14(a) violations

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**Abbey* stated:

> "Abbey argues that §14(a) has been violated here because CDC stockholders would not have voted to elect certain officers to grant certain stock options had the fact of the illegal foreign payments been disclosed in the proxy solicitations relative to those decisions. But he has made no showing that the details of those payments were relevant and material facts which a reasonably prudent stockholder would have considered in voting on the questions presented for stockholder approval. [Citing cases] The corporation's uncontroverted affidavits outlining the results of its internal investigation indicate that none of the CDC officers or employees who benefitted from the challenged proxy solicitations were directly involved in the illegal payments.
>
> "Several courts have refused to find a federal remedy under §14(a) for secret, illegal corporate payments. They have required 'transactional causation' as an essential element of a §14(a) cause of action: the harm to plaintiff-shareholders must have resulted from the corporate transactions which were authorized as a result of the false or misleading proxy solicitations. [Citing cases] Any injury to CDC shareholders from the corporation's illegal foreign payments stems directly from the corporate waste and mismanagement involved in authorizing those payments and not from allegedly misleading proxy solicitations dealing with unrelated corporate business matters." (603 F.2d at 732).

would be inconsistent with the federal policies underlying that section.

Subsequent to *Abbey* and *Lewis,* the Second Circuit decided *Galef v. Alexander, supra,* 615 F.2d 51, which held that a decision by directors to dismiss a stockholder's derivative action brought against themselves was inconsistent with the congressional policies underlying §14(a). *Galef* involved a decision by the Board of Directors to dismiss a stockholder's derivative action where the majority of the directors voting to dismiss the action were named as defendants. Petitioners submit that analysis in *Galef* of the congressional policy underlying §14(a) would preclude the dismissal of *any* non-frivolous stockholder's derivative action alleging §14(a) violations predicated on the business judgment rule, irrespective of whether the directors who determined to seek dismisal were named as defendants.

Galef, in analyzing the policy underlying §14(a), stated:

> "In *Borak*, the Court held that, in addition to the individual private right of action for violation of §14(a) found to exist under §27 of the 1934 Act, a derivative right of action must be inferred. The Court observed that in many instances derivative actions may be the only means of private redress for a violation of §14(a), and reasoned that denying a derivative right of action would be tantamount to denying a type of enforcement that is essential to the acomplishment of the goals of §14(a). 377 U.S. at 432. Describing the fundamental character of a claim of proxy violation as 'federal', and its importance as sometimes 'overriding' that of otherwise applicable state law, the Court observed that 'if the law of the State happened to attach no responsibility to the use of misleading proxy statements, the whole purpose of the section might be frustrated. 84 S.Ct. at 1561.
>
> The role of management in educating the stockholder sufficiently to allow him to cast an intelligent vote is unique. Those managing the corporation have the greatest access to relevant factual information. They have most clearly in mind the corporation's long-range plans. These factors and the directors' status as fiduciaries usually cause stockholders to give statements from management greater weight than they accord to the statements of corporate dissidents. Obviously the goal of §14(a) that communications from management

be accurate and complete as to all material facts is a vital one. Its achievement would quite clearly be frustrated if a director who was made a defendant in a derivative action for providing inadequate information in connection with a proxy solicitation were permitted to cause the dismissal of that action simply on the basis of his judgment that its pursuit was not in the best interests of the corporation. *The very premises which gives life to a derivative right of action to enforce §14(a) must save it from a premature death.* In short, we conclude that to the extent that a complaint states claims against directors under §14(a) upon which relief may be granted, federal policy prevents the summary dismissal of those claims pursuant to the business judgment of those defendant directors." (Emphasis added) 615 F.2d at 63-4)*

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* *Galef* stated:

"While we express no view as to whether a state law interpretation permitting non-defendant directors, or a duly appointed committee of disinterested non-directors, to initiate a business judgment dismissal of §14(a) claims would contravene federal policy, *cf. Burks v. Lasker, supra,* we note that the Ninth Circuit has opined that such a dismissal 'would in no way weaken the regulatory provisions of the federal securities laws. So long as those accused of manipulating the proxy vote are excluded from deciding whether or not to pursue the claim there is no conflict between the business judgment rule and §14(a).'
Lewis v. Anderson, supra at __, Fed.Sec. L. Rep. at 96,368." (615 F.2d at __ n20).

Subsequent to *Galef,* a District Court in *Maldonado v. Flynn,* 485 F.Supp. 279 (SDNY 1980) ("*Maldonado* New York") determined that *Galef* does not preclude a committee of disinterested directors from compelling the dismissal of a non-frivolous derivative action alleging §14(a) claims. Subsequent thereto, *Maldonado v. Flynn,* Del. Ch. 413 A.2d 1251 (1980) (appeal pending) (Maldonado-Delaware), held that Delaware law does not permit directors to utilize business judgment to compel the dismissal of a stockholder's derivative action charging breach of fiduciary duty by directors. The appeal in Maldonado-New York has been withdrawn, without prejudice, to the refiling, pending a determination of the appeal of "*Maldonado*-Delaware" to the Delaware Supreme Court.

C.

Plaintiff has alleged a §10(b) cause of action which has withstood a motion for summary judgment by defendants. Even though plaintiff has stated a non-frivolous §10(b) cause of action, the Court of Appeals has held that it could be dismissed under the business judgment rule.

Lewis, in holding that business judgment, as utilized in the instant case, is consistent with the policy underlying §10(b), stated:

> "As we have seen 'the overriding purpose of Section 10(b) and Rule 10b-5 was to protect the purity of the securities market . . . private claims for relief thereunder are a means to that end', *Rochelle v. Marine Midland Grace Trust Co. of N.Y.*, 535 F.2d 523, 532-33 (9th Cir. 1976). *We see no threat to the purity of the securities market from our interpretation of California Law.*" (Emphasis added) (A8)

The very premise relied on by *Lewis* as its basis for determining that business judgment is consistent with the Congressional purpose underlying §10(b), was rejected by the Court in *Superintendent of Insurance, supra,* 404 U.S. 6, 12, where it was held:

> "Hence we do not read §10(b) as narrowly as the Court of Appeals; it is not 'limited to preserving the integrity of the securities markets' (430 F.2d at 361), though that purpose is included. Section 10(b) must be read flexibly, not technically and restrictively. Since there was a 'sale' of a security and since fraud was used 'in connection with' it, there is redress under §10(b), whatever might be available as a remedy under state law.
>
> We agree that Congress by §10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement. But we read §10(b) to mean that Congress meant to bar deceptive devices and contrivances in the purchase or sale of securities *whether conducted in the organized markets or face to face.*" (Emphasis added)

Superintendent of Insurance held that corporations as

well as individuals are protected under §10(b) and Rule 10b-5, 404 U.S. at 10. The derivative action has been essential in accomplishing the congressional purpose underlying §10(b) claims where the corporation is the defrauded purchaser or seller.*

Petitioners submit that if a state law which permits directors, in the exercise of their business judgment, to compel the dismissal of a stockholder's derivative action, is allowed to dismiss an action alleging §10(b) violations, the congressional purpose underlying that section will be frustrated.

This Court, in *Burks* stated that if state law permits disinterested directors to dismiss a stockholder's derivative action, the next inquiry is whether such a state rule is consistent with the policy underlying the federal statute sued under (441 U.S. 480). Petitioners submit that surely this Court had in mind some federal statutes when it formulated the two tier test. If §10(b) and 14(a) claims cannot withstand business judgment, we cannot imagine any federal statute withstanding business judgment. Petitioners submit that if directors can compel the dismissal of a non-frivolous derivative action seeking redress under §§10(b) or 14(a), then clearly *Burks* formulated a meaningless test.

D.

Lewis, in dictum, analogized the business judgment rule with 10b-5, which the Court stated "affords no cause of

* See: *Goldberg v. Meridor,* 567 F.2d 209 (2d Cir. 1977) *cert. denied,* 434 U.S. 1069 (1978); *Schoenbaum v. Firstbrook,* 405 F.2d 200 (2d Cir.), *rev'd.* 405 F.2d 215 (2d Cir. 1968 (en banc), *cert. denied* 395 U.S. 906 (1969); *Ruckle v. Roto American Corp.,* 339 F.2d 24 (2d Cir. 1964); *Pappas v. Moss,* 393 F.2d 865 (3d Cir. 1968); *Rekant v. Desser,* 425 F.2d 872 (5 Cir. 1970); *Shell v. Hensley,* 430 F.2d 819 (5 Cir. 1970); *Bailey v. Meister Brau Inc.,* 535 F.2d 982 (7th Cir. 1976); *Wright v. The Heizer Corp.,* 560 F.2d 236 (7th Cir. 1977); *Dasho v. Susquehanna Corp.,* 461 F.2d 11, 26 7th Cir. 1972), *cert. denied,* 408 U.S. 925 (1972).

action for negligence." Petitioners submit that the Court's reasoning is in conflict with *Gould v. Hawaii S.S. Co.*, 535 F.2d 761 (3rd Cir. 1976) and *Gerstle v. Gamble-Skogmo Inc.*, 478 F.2d 1281 (2d Cir. 1973), which held that §14(a) merely requires proof of negligence.* To take the Court's statement to its logical conclusion, if as *Gould* and *Gamble* hold, the federal policy enunciated in §14(a) requires directors soliciting proxies to be free from negligence, nonetheless a committee of directors can bar maintenance of an action alleging §14(a) violations if plaintiff is unable to prove that the committee acted in bad faith. Petitioners submit that this dictum in *Lewis* is in direct conflict with the congressional intent.

E.

There is a conflict between the holding in *Lewis* concerning the utilization of state law to dismiss non-frivolous stockholders' derivative actions alleging violations of §§10(b) and 14(a) and the Supreme Court's holdings in *Borak* and *Superintendent of Insurance.*

There is a conflict in policy in the circuits as to the application of the *Burks* test to the utilization of business judgment to dismiss §§10(b) and 14(a) claims. See: *Galef, Abbey* and *Lewis.*

There are numerous cases now pending in various District Courts involving the issue of whether business judgment can be utilized to terminate non-frivolous claims predicated upon violations of §§10(b) and 14(a). We respectfully submit that the time has come for this Court to confront and resolve the issue of whether a state law permitting the use of business judgment can thwart the underlying policy of Congress in enacting §§10(b) and 14(a).

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*In California, the cases hold that directors in exercising business judgment must act with diligence. See: *Burt v. Irvine, supra,* 47 Cal. Rptr. at 407.

CONCLUSION

For all the reasons set forth above, a Writ of Certiorari should be granted to review the opinion and determination of the United States Court of Appeals for the Ninth Circuit.

Respectfully submitted,

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APPENDIX A

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

FILED: OCT. 29 1979
RICHARD H. DEANE
Clerk U.S. Court of Appeals

No. 79-3021

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

HARRY LEWIS and SYLVIA BAKER,
Plaintiffs-Appellants,

v.

WILLIAM E. ANDERSON, S. CLARK BEISE, SHIRLEY T. BLACK, ROY E. DISNEY, RONALD W. MILLER, RICHARD T. MORROW, DONN B. TATUM, E. CARDON WALKER, RAYMOND L. WATSON, WALT DISNEY PRODUCTIONS, GEORGE L. BAGNALL and GORDON E. YOUNGMAN,
Defendants-Appellees.

Appeal from the United States District Court for the Central District of California

Before: WRIGHT and GOODWIN, Circuit Judges, and SOLOMON, Senior District Judge.*

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*Of the District of Oregon.

WRIGHT, Circuit Judge:

Two minority shareholders of Walt Disney Productions appeal from partial summary judgment barring their derivative action against certain directors. The district court ruled that the board may appoint a "special litigation committee" to determine whether maintaining the action is in the corporation's best interests. So long as the committee exercises its best business judgment, its decision to dismiss the action will be honored by the courts. The court reserved for trial the question whether the committee did exercise good faith business judgment. We granted review under 28 U.S.C. §1292(b) and Rule 5 of the Federal Rules of Appellate Procedure.

FACTS

The essential facts are not in dispute. In 1973, Walt Disney Productions (Disney) adopted a stock option plan for key employees. In November, 1974, the board-appointed "stock option committee" granted new options, allegedly more favorable to defendant directors. Appellants contend that the issuance of the new options, and management's behavior in seeking shareholder approval of the new option plan, violated federal securities laws.

This court need not decide the validity of any of these contentions, for the only issue before us is whether the special litigation committee appointed by the directors had authority to dismiss the action.

When appellants filed this action in February, 1976, Disney's board of directors delegated to a "special litigation committee" granted new options, allegedly more favorable to defendant directors. Appellants contend that the issuance of the new options, and management's behavior in seeking shareholder approval of the new option plan, violated federal securities laws.

The committee met nine times, and retained independent legal counsel. It decided that it would not be in Disney's best interests to pursue the litigation. The committee's counsel moved for summary judgment on the issue of its authority to dismiss the action. The trial court granted the motion, holding that *if* the committee exercised its business judgment in deciding to terminate the action, that decision could not be challenged derivatively, but reserved for a court trial the factual determination of whether the committee actually made a good faith determination. We limit our review to the legal question whether a good faith determination by the committee bars any further action by a shareholder on behalf of the corporation.

DISCUSSION

In answering the question, we are aided, as the district court was not, by the recent decision in *Burks v. Lasker,* —U.S.—, 99 S.Ct. 1831 (1979), decided May 14, 1979. It gives added weight to the decision below.

In *Burks* the Court held that whether a special committee of disinterested directors may dismiss a derivative action brought against other board members, depends on the relevant state law. In that case, the derivative action charged the directors with violations of the Investment Company and Investment Advisers Acts. As in the present case, members of the board who were not involved in the alleged violations comprised a "special litigation committee" and independently decided that the action was not in the corporation's best interests.

The Supreme Court held that the role of the federal court in such a case is limited to two inquiries: whether the relevant state law allows the board to delegate power to dismiss the action to a special litigation committee, and whether such state laws are consistent with relevant federal law.

In light of *Burks,* we must determine (1) whether California law requires the dismissal of an action once a duly delegated committee determines that the action is not in the corporation's best interests, and (2) whether such a rule is consistent with the Securities Exchange Act of 1934. We answer both questions in the affirmative.

THE APPLICABLE LAW

Because Disney is a California corporation, California law controls. Our search for the applicable state law follows the guidelines established by the Supreme Court:

> [T]he State's highest court is the best authority on its own law. If there be no decision by that court then federal authorities must apply what they find to be the state law after giving "proper regard" to relevant rulings of other courts of the State. In this respect, it may be said to be, in effect, sitting as a state court.

Commissioner of Internal Revenue v. Estate of Bosch, 387 U.S. 456, 465 (1967), quoting *Bernhardt v. Polygraphic Co.,* 350 U.S. 198 (1956).

We accord "substantial deference" to the district judge's interpretation of the law of the state in which he sits. *United States v. Valley National Bank,* 524 F.2d 199, 201 (9th Cir. 1975).

The California Supreme Court has never faced the issue presented here; we therefore "sit as a state court" and look for guidance from intermediate appellate courts in California, and from courts in other jurisdictions which have recently considered the question.

THE BUSINESS JUDGMENT RULE

California law has long recognized the "business judgment rule," holding that directors' decisions in the day to day management of the corporation may not be attacked by

shareholders so long as the directors exercised their "business judgment" in making those decisions. This rule applies to the courts as well:

> Neither the court nor minority shareholders can substitute their judgment for that of the corporation "where its board has acted in good faith and used its best business judgment in behalf of the corporation."

Marsili v. Pacific Gas and Electric Company, 51 Cal. App.3d 313, 324, 124 Cal. Rptr. 313, 320 (1975), citing *Olson v. Basin Oil Co.,* 136 Cal. App.2d 543, 559-60, 288 P.2d 952, 980 (1955).

The business judgment rule applies to all discretionary decisions by the board, including the decision not to pursue a cause of action:

> Where a board of directors, in refusing to commence an action to redress an alleged wrong against a corporation, acts in good faith within the scope of its discretionary power and reasonably believes its refusal to commence the action is good business judgment in the best interest of the corporation, a stockholder is not authorized to interfer with such discretion by commencing the action.

Findley v. Garrett, 109 Cal. App.2d 166, 174, 240 P.2d 421, 426 (1952).

The same rule was stated by Justice Brandeis:

> Whether or not a corporation shall seek to enforce in the courts a cause of action for damages is, like other business questions, ordinarily a matter of internal management and is left to the discretion of the directors, in the absence of instruction by vote of the stockholders. Courts interfere seldom to control such discretion *intra vires* the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation which prevents an unprejudiced exercise of judgment;...

United Copper Securities Co. v. Amalgamated Copper Co., 244 U.S. 261, 263-4 (1917).

Appellants claim this rule does not apply when a majority of the board is charged with wrongdoing in the very action sought to be dismissed. The application of the rule to such a case would be improper. But here, the directors who are accused of wrongdoing have not decided to dismiss the case. They have appointed a committee of disinterested directors to make an independent determination of the merits of the action. Several recent cases have extended the business judgment rule to such situations.

Abbey v. Control Data Corp., —F.2d— (8th Cir. 1979), is the first federal case to decide the issue since *Burks v. Lasker, supra,* was decided. Following the two-step approach mandated by *Burks*, the Eighth Circuit held that under Delaware law the business judgment rule extends to the decision of a special litigation committee to dismiss a derivative action against board members. The court also held that this interpretation of Delaware law is consistent with federal securities laws.

Abbey is particularly helpful here, not only because it is the first post-*Burks* decision by a federal court of appeals, but also because the Delaware statute construed is almost identical to the California statute.1 Each authorizes a corporate board of directors to appoint committees to act for the Board. We agree with the Eighth Circuit that the business judgment rule

> applies to any reasonable good faith determination by an independent board of directors that the derivative action is not in the best interests of the corporation.

—F.2d— (Slip op. p. 11).

We also draw guidance from a recent decision by New York's Court of Appeals. In *Auerbach v. Bennett,* 47 N.Y.2d 619, —N.Y.S.2d— (1979), that court held:

> [T]he substantive aspects of a decision to terminate a

> shareholders' derivative action against defendant corporate directors made by a committee of disinterested directors appointed by the corporation's board of directors are beyond judicial inquiry under the business judgment doctrine, . . .

47 N.Y.2d at 623.

The court appropriately noted that the fact that the independent committee members were appointed by interested directors is an "inescapable" aspect of "the corporation's predicament." Although the situation presents problems, there is no alternative:

> To assign responsibility of the dimension here involved to individuals wholly separate and apart from the board of directors would, except in the most extraordinary circumstances, itself be an act of default and breach of the nondelegable fiduciary duty owed by the members of the board to the corporation and to its shareholders, employees and creditors. For the courts to preside over such determinations would similarly work an ouster of the board's fundamental responsibility and authority for corporate management.

47 N.Y.2d at 633.

We agree. *Auerbach* and *Abbey* reflect a clear trend in corporate law, and we are confident that a California court would follow this trend. As the *Auerbach* court recognized, a court may "inquire as to the disinterested independence of the members of that [special litigation] committee and as to the appropriateness and sufficiency of the investigative procedures chosen and pursued by the committee." 47 N.Y.2d at 623-624. At trial the district court will make that inquiry. Our decision here, like that in *Auerbach,* is that the good faith exercise of business judgment by a special litigation committee of disinterested directors is immune to attack by shareholders or the courts.

Our decision is supported not only by case law but by sound policy considerations. To allow one shareholder to

incapacitate an entire board of directors merely by leveling charges against them gives too much leverage to dissident shareholders. There is no reason to believe that a minority shareholder is more likely to act in the best interest of the corporation than are directors who are elected by a majority of the stockholders.

FEDERAL SECURITIES LAWS

As noted above, the Supreme Court's decision in *Burks* requires us to decide if our interpretation of California law conflicts with the underlying policies of the federal securities laws. We hold that it does not.

As a starting point we note that in *Burks* the Court held that an interpretation of state law allowing disinterested directors to dismiss a derivative suit brought under the Investment Company and Investment Advisors Acts would not be consistent with the Acts. We note further that the Eighth Circuit has found that such an interpretation of state law does not conflict with the underlying policy of §§ 13(a) and 14(a) of the Securities Exchange Act, the Act we examine here.2

As we have seen, "the overriding purpose of Section 10(b) and Rule 10b-5 was to protect the purity of the securities market and . . . private claims for relief thereunder are a means to that end." *Rochelle v. Marine Midland Grace Trust Co. of N.Y.*, 535 F.2d 523, 532-33 (9th Cir. 1976). We see no threat to the purity of the securities market from our interpretation of California law.

The business judgment rule, as we interpret it, would not bar a derivative action when a special litigation committee of disinterested directors dismisses an action in bad faith. It operates only to insulate the committee's good faith decision to dismiss an action, even if that decision is negligent. In that sense the business judgment rule is closely analogous to Rule 10b-5 itself, which affords no cause of

action for negligence. *Ernst & Ernst v. Hochfelder,* 425 U.S. 185 (1976). As one post-*Ernst* Circuit court has said:

> Section 10(b) and Rule 10b-5 were not intended to bring within their ambit simple corporate mismanagement or every imaginable breach of fiduciary duty in connection with a securities transaction.

St. Louis Union Trust Co. v. Merrill Lynch, etc., 562 F.2d 1040, 1048 (8th Cir. 1977). That description of Rule 10b-5 is an equally apt description of the business judgment rule. We find, in sum, that the two rules can coexist harmoniously.

The same reasoning holds true for the disclosure requirements of §14(a), which are designed to "prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitations." *J.I. Case Co. v. Borak,* 377 U.S. 426, 431 (1964).

Allowing disinterested directors to exercise their business judgment to dismiss what they see as groundless causes of action would in no way weaken the regulatory provisions of the federal securities laws. So long as those accused of manipulating the proxy vote are excluded from deciding whether or not to pursue the claim there is no conflict between the business judgment rule and §14(a).

Appellants contend also that the court below erred in dismissing the complaint without notice to the shareholders. The argument is frivolous in that this is not a voluntary dismissal. Moreover, the case has not been dismissed. The court granted only *partial* summary judgment.

Appellants' contention that the court's action denies them due process is equally frivolous. Their action is brought on the corporation's behalf, not their own, and they have no compensable property right at stake.

Finally, appellants contend that the court erred in denying their motion for a jury trial. We agree with the court below that application of the business judgment doctrine is essentially a "standing" issue: if the doctrine is applicable, then plaintiffs have no standing to sue. Therefore the district court properly held that no jury trial was required to determine this purely equitable question. See *Ross v. Bernhard,* 396 U.S. 531, 538 (1970), where the Court noted that "the stockholder's right to sue on behalf of the corporation [is] historically an equitable matter," and triable by the court without a jury.

Because the court below correctly determined that the business judgment doctrine applies to that instant case, we affirm.

AFFIRMED.

FOOTNOTES

1. Each statute permits a corporate board to appoint a committee to act for the board. The Delaware code provides:

> (c) The board of directors may, by resolution passed by a majority of the whole board, designate 1 or more committees, each committee to consist of 1 or more of the directors of the corporation. The board may designate 1 or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. . . . Any such committee, to the extent provided in the resolujtion of the board of directors, or in the bylaws of the corporation, shall have and may exercise all the powers and authority of the board of directors in the management of the business and affairs of the corporation, and may . . . .

8 Del. C. §141(c).

The analogous California statute reads, in relevant part:

> The Board may, by resolution adopted by a majority of the authorized number of directors, designate one or more committees, each consisting of two or more directors, to serve at the pleasure of the board. . . . Any such committee, to the extent provided in the resolution of the board or in the

bylaws, shall have all the authority of the board, except with respect to [seven exceptions not relevant here] . . .

Cal. Corp. Code §311 (West 1977).

2. The foundation of the §10(b) claim here is that the directors had inside information that in November, 1974 the price of Disney stock was low, and that options granted to buy at that price would be profitable. Disney stock did in fact go up and the directors profited from their options. The foundation of the §14(a) claim is that the proxy statements sent to shareholders in January, 1975, and December, 1975 did not fully disclose the alleged violations of federal law by defendant directors in enacting the 1974 stock option plan.

APPENDIX B

FINDINGS OF FACT AND CONCLUSIONS OF LAW ISSUED BY THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

FILED—Aug 8—1978—Clerk, U.S. District Court, Central District of California

No. CV 76-549-IH

HARRY LEWIS and SYLVIA BAKER,

Plaintiffs,

v.

WILLIAM H. ANDERSON, et al,

Defendants.

On June 30, 1978, there duly came on for hearing before the Honorable Irving Hill, United States District Judge, a hearing on legal and evidentiary issues raised by various motions of the several parties relating to the business judgment rule.

Plaintiffs appeared by Garwin & Bronzaft, by Sidney L. Garwin, Esq.; Defendant Walt Disney Productions appeared by Beardsley, Hufstedler & Kemble by Seth M. Hufstedler, Esq., Burton J. Gindler, Esq., and Laurie D. Zelon, Esq.; Defendants William H. Anderson, Roy E. Disney, Ronald W. Miller, Richard T. Morrow, Donn B. Tatum and E. Cardon Walker (the "inside Defendants") appeared by Donovan, Leisure, Newton & Irvine by Samuel W. Murphy, Jr., Esq.; and Defendants S. Clark Beise, Shirley T. Black, Raymond L.

Watson, George L. Bagnall, Jr. and Michael L. Bagnall as executors of the Estate of George L. Bagnall, Deceased, and Gordon E. Youngman (the "outside Defendants") appeared by Agnew, Miller & Carlson, by Robert E. Carlson, Esq., and Stanley H. Williams, Esq. The matter was argued and submitted.

Good cause appearing therefor, the Court now makes its findings of fact and conclusions of law.

FINDINGS OF FACT

It is true that:

1. At all relevant times:

a. Walt Disney Productions was a California corporation.

b. Walt Disney Productions' by-laws provided for a Board of Directors of nine persons, and further provided that a quorum of four persons was necessary for the transaction of business by the Board.

c. Walt Disney Productions' Board of Directors had a three-person Executive Committee.

2. On April 20, 1976, Walt Disney Productions' Executive Committee duly appointed a Special Litigation Committee by resolution which read:

> "NOW, THEREFORE, BE IT RESOLVED: That in accordance with Section 822 of the California Corporations Code and Article IV of the Bylaws of the Corporation, there is hereby established a Special Litigation Committee which shall have and may exercise all the powers and authority of the Board of Directors of the Corporation with respect to all matters affecting the interests of the Corporation in this litigation [*i.e.*, the subject litigation, *Lewis v. Anderson*], including, without limitation, the selection, retention, direction, and discharge of special legal counsel to represent the Corporation in this matter, the determination of the Corporation's position in this suit and the taking of any

other action which from time to time may be necesary or appropriate, in the sole discretion of the Committee, to facilitate the Committee's ability to discharge its responsibilities.

"RESOLVED FURTHER, that in accordance with Section 4 of Article IV of the Bylaws of the Corporation, the Special Litigation Committee shall fix its own rules of organization and procedures.

"RESOLVED FURTHER, that Caroline Leonetti Ahmanson, Philip M. Hawley and Raymond L. Watson are hereby appointed to serve on the Special Litigation Committee." (Bracketed material added.)

By resolution adopted June 1, 1976, Walt Disney Productions' Board of Directors duly ratified this action of its Executive Committee.

3. Prior to January 1, 1977, the Special Litigation Committee commenced consideration of the position that Walt Disney Productions should take in this lawsuit but reached no decision until late August of 1977. On September 13, 1977, pursuant to its decision reached in late August 1977, the Special Litigation Committee adopted a resolution instructing its counsel to seek a dismissal upon the ground that such dismissal was in the best interests of Walt Disney Productions and its stockholders. The Board of Directors of Walt Disney Productions was aware that the Special Litigation Committee had not arrived at any decision prior to January 1, 1977, and that thereafter said committee continued to exercise the power and authority which had been delegated to it by the Board as aforesaid. The Board never, before or after January 1, 1977, purported to modify or withdraw the said delegation at any time.

4. Of the nine persons serving on the Board of Directors of Walt Disney Productions as of, and subsequent to, April 20, 1976, six (the "inside Defendants") are beneficiaries of the option grants being attacked in this lawsuit and are

defendants herein. The other three directors, Ms. Ahmanson, Mr. Hawley and Mr. Watson, are the members of the Special Litigation Committee. Ms. Ahmanson and Mr. Hawley are not defendants in this lawsuit.

The other five individual Defendants (the "outside Defendants") include four persons who were directors at the time of the alleged wrongful grants, but are no longer directors, and Mr. Watson, who was a director at the time of the alleged wrongful grants and continues to serve as a director. None of the outside Defendants was a beneficiary of the option grants being attacked by Plaintiffs in this lawsuit.

5. Since January 1, 1977, there has been no express resolution of Walt Disney Productions' Executive Committee or Board of Directors re-creating the Special Litigation Committee or confirming its authority.

6. a. On November 23, 1976, Walt Disney Productions' Board of Directors adopted a resolution that at the February 9, 1977 shareholders meeting, there should be submitted to Walt Disney Productions' shareholders a resolution recommended by the Special Litigation Committee relating to the option grants challenged in Plaintiffs' complaint. Said resolution is found as Exhibit A to the Supplemental Affidavit of Luther Marr in Support of Motion for Summary Judgment. Pursuant to said resolution, the notice of that February 9, 1977 shareholders' meeting was dated January 7, 1977, and distributed to the shareholders on or about that date; and the accompanying proxy statement fully described the authority granted to the Special Litigation Committee by Walt Disney Productions' Board of Directors.

b. This publication after January 1, 1977, of that proxy statement indicates that Walt Disney Productions' Board of Directors was aware of and intended to continue and ratify the authority of the Special Litigation Committee after January 1, 1977; and Walt Disney Productions' Board

of Directors did thereby impliedly ratify the authority of the Special Litigation Committee established in the earlier resolutions (Finding 2 above).

7. The Court finds as a fact any conclusion of law that may be construed in part or in whole as a proper finding of fact.

CONCLUSIONS OF LAW

From the foregoing facts, the Court concludes:

1. a. The Board of Directors of Walt Disney Productions, a California corporation, validly delegated to the Special Litigation Committee the authority to determine in the exercise of its business judgment what response Walt Disney Productions should make to this lawsuit, including the possibility of Walt Disney Productions' seeking dismissal.

b. Such delegation of authority was valid on one or more of the following grounds:

(1) under the common law and former Section 822 of the old California Corporations Code effective prior to January 1, 1977 (*Dyer Bros. Golden West Iron Works v. General Iron Works,* 182 Cal. 588, 189 P.443 (1920));

(2) under Section 311 of the new California Corporations Code effective January 1, 1977 (a) by operation of law or (b) by implied ratification.

The Court's conclusion of law under subparagraph (2) above assumes *arguendo* that the authority granted by the Board of Directors to the Special Litigation Committee was not validly granted as of any date prior to January 1, 1977. Nevertheless, on the facts of this case, the Court believes that a holding, as Plaintiffs seek, that the business judgment rule is unavailable because of the lack of any express new delegation or ratification after January 1, 1977, is incorrect legally and should not be followed. Such a holding would exalt form over substance and would work an injustice. In

this case, all decisions of the Special Litigation Committee were taken and made after January 1, 1977. Moreover, the Board of Directors, after January 1, 1977 (in connection with a resolution of ratification relating to the New Option grants), gave a full description to the stockholders of the authority previously granted to the Special Litigation Committee by the Board of Directors and of the actions taken and recommendations made by the Special Litigation Committee up to November 1976. The stockholders thereafter passed the resolution. Certainly the change in the law evidenced by the adoption of the new California Corporations Code demonstrates that there has never been any immutable policy in California that a corporation's board of directors may not delegate a portion of its power to a committee of board members. Public policy considerations and the equities of the case militate toward allowing the Defendants to have available to them the business judgment rule if it is otherwise found applicable.

2. The Special Litigation Committee can validly exercise the business judgment of the Board of Directors of Walt Disney Productions, even though the Special Litigation Committee's membership numbers less than a majority or quorum of Walt Disney Productions' Board.

3. The Special Litigation Committee can validly exercise business judgment to seek dismissal of this lawsuit attacking option grants as violative of Walt Disney Productions' 1973 Stock Option Plan, even though the adoption or alleged modification of that plan, or options granted pursuant thereto, required the approval of Walt Disney Productions' shareholders.

4. Dismissal of this shareholders' derivative action alleging violations of federal securities laws may legally be sought on the basis of the business judgment rule; and dismissal on that basis does not violate any policy of such laws or serve as a ratification of such alleged violations.

5. Dismissal of this shareholders' derivative action to

the extent it may allege fraud, waste or illegal acts may legally be sought upon the basis of the business judgment rule; and dismissal on that basis does not constitute a ratification of any such alleged acts.

6. Trial of the factual issues relating to the business judgment decision of the Special Litigation Committee to seek dismissal of this action is an equitabl eproceeding triable by the Court without a jury.

7. Trial and pre-trial on the issues relating to the business judgment decision of the Special Litigation Committee to seek dismissal of this action shall be bifurcated from other issues in the lawsuit and shall be conducted first.

8. Prior to January 1, 1977, the conduct of the affairs of California corporations was governed by the common law and the old California Corporations Law, including Section 822. On January 1, 1977, the new California Corporations Law, including Section 311, became effective.⅓

9. Thgere are no genuine issues of fact as to the facts found herein upon which these conclusions are based.

10. The Court makes as a conclusion of law any finding of fact that may be construed in part or in whole as a proper conclusion of law.

Let partial summary judgment issue in accordance herewith.

DATED: August 8, 1978

s/Irving Hill
Judge, United States District Court

APPENDIX C

ORDER OF PARTIAL SUMMARY JUDGMENT RENDERED BY THE DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

NO. CV 76-549-IH

PARTIAL SUMMARY JUDGMENT

HARRY LEWIS and SYLVIA BAKER,

Plaintiffs,

v.

WILLIAM H. ANDERSON, et al,

Defendants.

On June 30, 1978, there duly came on for hearing before the Honorable Irving Hill, United States District Judge, a hearing on legal and evidentiary issues raised by various motions of the several parties relating to the business judgment rule.

Plaintiffs appeared by Garwin & Bronzaft, by Sidney L. Garwin, Esq.; Defendant Walt Disney Productions appeared by Beardsley, Hufstedler & Kemble by Seth M. Hufstedler, Esq., Burton J. Gindler, Esq., and Laurie D. Zelon, Esq.; Defendants William H. Anderson, Roy E. Disney, Ronald W. Miller, Richard T. Morrow, Donn B. Tatum and E. Cardon Walker (the "inside Defendants") appeared by Donovan, Leisure, Newton & Irvine, by Samuel W. Murphy, Jr., Esq.; and Defendants S. Clark Beise, Shirley T. Black, Raymond L. Watson, George L. Bagnall, Jr., and Michael L. Bagnall as

executors of the Estate of George L. Bagnall, deceased, and Gordon E. Youngman (the "outside Defendants") appeared by Agnew, Miller & Carlson, Esq., and Stanley H. Williams, Esq. The matter was argued and submitted.

Good cause appearing therefor, and the Court having made its findings of fact and conclusions of law;

IT IS ORDERED AND DECLARED:

1. The Board of Directors of Walt Disney Productions, a California corporation, validly delegated to the Special Litigation Committee the authority to determine in the exercise of its business judgment what response Walt Disney Productions should make to this lawsuit, including the possibility of Walt Disney Productions' seeking dismissal.

2. The Special Litigation Committee can validly exercise the business judgment of the Board of Directors of Walt Disney Productions, even though the Special Litigation Committee's membership numbers less than a majority or quorum of Walt Disney Productions' Board.

3. The Special Litigation Committee can validly exercise business judgment to seek dismissal of this lawsuit attacking option grants as violative of Walt Disney Productions' 1973 Stock Option Plan, even though the adoption or alleged modification of that plan, or options granted pursuant thereto, required the approval of Walt Disney Productions' shareholders.

4. Dismissal of this shareholders' derivative action alleging violations of federal securities laws may legally be sought on the basis of the business judgment rule; and dismissal on that basis does not violate any policy of such laws or serve as a ratification of such alleged violations.

5. Dismissal of this shareholders' derivative action to the extent it may allege fraud, waste or illegal acts may legally be sought upon the basis of the business judgment rule; and dismissal on that basis does not constitute a ratification of any such alleged acts.

6. Trial of the factual issues relating to the business judgment decision of the Special Litigation Committee to

seek dismissal of this action is an equitable proceeding triable by the Court without a jury.

7. Trial and pre-trial on the issues relating to the business judgment decision of the Special Litigation Committee to seek dismissal of this action shall be bifurcated from other issues in the lawsuit and shall be conducted first.

8. Pursuant to 28 U.S.C. §1292(b), the Court declares that this Partial Summary Judgment involves controlling questions of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the Partial Summary Judgment may materially advance the ultimate termination of the litigation in this case.

DATED: August 8, 1978.

s/ Irving Hill
IRVING HILL, Judge
United States District Court

APPENDIX D

ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT GRANTING PLAINTIFFS' PERMISSION TO FILE PURSUANT TO 28 U.S.C. §1292(b)

FILED JAN 11 1979—U.S. COURT OF APPEALS
NO. 78-8186

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

HARRY LEWIS and SYLVIA BAKER,
Plaintiffs-Petitioners,

v.

WILLIAM H. ANDERSON, S. CLARK BEISE, SHIRLEY T. BLACK, ROY E. DISNEY, RONALD W. MILLER, RICHARD T. MORROW, DONN B. TATUM, E. CARDON WALKER, RAYMOND L. WATSON, WALT DISNEY PRODUCTIONS, GEORGE L. BAGNALL, and COURDON E. YOUNGMAN,
Defendants-Respondents.

Before: WRIGHT, GOODWIN and KENNEDY, Circuit Judges.

Upon due consideration, the petition for permission to appeal is granted. Upon the filing of appellees' brief, the Clerk shall calendar the appeal for expedited consideration.

APPENDIX E

ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT DENYING APPELLANTS' PETITION FOR REHEARING AND REJECTING SUGGESTION FOR REHEARING EN BANC

NO. 79-3021, DC No. CV 76-549

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

HARRY LEWIS and SYLVIA BAKER,
Plaintiffs-Appellants,

v.

WILLIAM H. ANDERSON, S. CLARK BEISE, SHIRLEY T. BLACK, ROY E. DISNEY, RONALD W. MILLER, RICHARD T. MORROW, DONN B. TATUM, E. CARDON WALKER, RAYMOND L. WATSON, WALT DISNEY PRODUCTIONS, GEORGE L. BAGNALL, and COURDON E. YOUNGMAN,
Defendants-Appellees.

Before: WRIGHT and GOODWIN, Circuit Judges, and SOLOMON, District Judge.

The panel as constituted in the above case has voted to deny the petition for rehearing. Judges Wright and Goodwin have voted to reject the suggestion for a rehearing en banc.

The full court has been advised of the suggestion for an en banc hearing, and no judge of the court has requested a vote on it. Fed. R. App. P. 35(b).

The petition for rehearing is denied and the suggestion for a rehearing en banc is rejected.

APPENDIX F

STATUTES AND RULES INVOLVED

Section 10(b), 15 U.S.C. §78j(b):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, 17 C.F.R. §240.10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Section 14(a), 15 U.S.C. 78n(a):

It shall be unlawful for any person, by the use of the

mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 12 of this title.

Rule 14a-9, 17 C.F.R. §240.14a-9:

(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

(b) The fact that a proxy statement, form of proxy or other soliciting material has been filed with or examined by the Commission shall not be deemed a finding by the Commission that such material is accurate or complete or not false or misleading, or that the Commission has passed upon the merits of or approved any statement contained therein or any matter to be acted upon by security holders. No representation contrary to the foregoing shall be made.